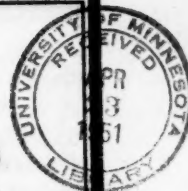




1951

Monthly Letter on Economic Conditions Government Finance



New York, April, 1951

General Business Conditions

THE business news during March has provided a welcome combination of sustained production and employment reports, together with evidence of at least a temporary check in the advance of inflationary forces. The long rise of wholesale prices has flattened out. Staple commodities average a little lower. Retail trade figures, after adjustment for the early Easter, have dropped below earlier months. Wholesale merchandise markets have been sluggish, and general industrial buying, after reaching extraordinary peaks, has subsided considerably.

It is not usual to welcome a slackening of trade, but the rush to buy in January and early February reflected an inflationary psychology which, however reasonable in view of the influences operating to raise costs and prices, was nevertheless a threat to order and stability. Both at retail and wholesale, business was borrowed from the future. The danger in such movements is that anticipation is overdone and commitments over-extended, inviting reaction. Meanwhile the

buying tends to produce the very results, namely shortages and higher prices, which the buyers fear.

After this precautionary buying, a pause was inevitable. The industries have huge unfilled orders to work against, and with few exceptions will be as active as their supplies of materials will allow. In the markets the situation is now being appraised more calmly. Merchandise reports show that fears of shortage were overdone, for store stocks are ample and in a few lines goods are backing up. The dominating fact is that the country is turning out substantially more goods and services than ever before in peacetime, and more than 90 per cent of the output is still for civilian use. People who under-rated industry's productive power are finding that supplies are more abundant, even in durable goods, than they expected a few months ago. More of almost everything, including automobiles, is being turned out than at this time last year. Rising inventories reflect the enormous output. While cutbacks in durable goods will take effect increasingly, the inducement to anticipate requirements, and to build up inventories further, is weakened in many lines.

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Influences for Quieter Markets

It is also likely that international and Washington reports have helped to quiet the markets. The feeling has gained ground that events permit a little more consideration for civilian wants and a little more care to keep civilian industries going until the materials they are using are actually required for defense work, which in many cases waits on the completion and tooling up of new plants. Whether this feeling will be justified as time goes on, or whether it is doomed to disappointment, would now be hard to say. Undoubtedly the program to break down supply bottlenecks, get plants ready and start defense output rolling will be pushed with all of Mr. Wilson's great vigor, and as far as national policy declares to be necessary. The other side of

the matter is that defense is a long-run necessity, without foreseeable end, and that the capacity of the country to sustain and finance it indefinitely must be preserved.

Relaxation of government stockpiling purchases of certain commodities has eased market pressures. Discontinuance of tin purchases because prices had moved far out of line, considering the excess of production over the restricted consumption, was construed as notice that the program of continuously building up stockpiles regardless of the effect on prices was being re-examined.

A further quieting effect on sentiment has been exerted by the changes in money policy and the restraints on lending adopted by bankers, which are discussed subsequently in this Letter. The feeling that the boom will be checked, as often in the past, by tightening credit is finding more support. Probably it is supplemented by the evidence that the January budget figures underestimated the Government's tax revenues considerably and that the Treasury will end the current fiscal year with a surplus instead of a deficit, thus taking more out of the income stream than it returns to it. The need now is to adopt the economy and tax measures necessary to balance the fiscal 1952 budget also; and if that is done it will be possible to say that fiscal and monetary policy are at last working together effectively to combat inflation.

Mainsprings of Activity

It would be hard to show that the month's developments portend more than a spotty let-down of industrial operations, if any. Among the current business figures two stand out strikingly. One is the announcement that awards of defense contracts since the first of the year have been running at a rate of \$5 billion monthly. Time will be required, in some instances a good many months, to get plants ready to produce against these contracts, but a steady increase in armament output over the next twelve months is certain.

The second important figure is supplied by the Securities and Exchange Commission and the Department of Commerce, which report that expenditures for new plant and equipment by American business in 1951 promise to reach a record of \$23.9 billion. This is 29 per cent more than in 1950, and 24 per cent above the previous peak in 1948. The survey indicates that at least two-thirds of the increase over 1950 represents higher physical volume. An earlier survey made last December placed the expected

total at \$21.9 billion; thus the new figure represents an expansion of previous plans.

Business expansion programs and projected government expenditures for defense are the mainsprings of present industrial activity. They have been anticipated and to some extent discounted, but they have provided the industries with immense unfilled orders. As operations expand employment will be available in these areas to offset contraction elsewhere, whether due to scarcities or to softening demand. Purchasing power will flow from the production set in motion by the government and industrial orders and will in turn flow into the markets for other goods and services.

Inflationary Implications

The implication of these figures is that the country should feel less concern over a possible business let-down than over a possible return of complacency as to inflationary dangers. To provide \$24 billion of new business plant and equipment in a year, even at current high prices, will require an enormous effort in the capital goods industries and materials and working forces of record-breaking peacetime size. The pressure on these industries is shown by a twenty months' backlog of unfilled orders for machine tools at current rates of shipment, and to a lesser extent by the inability of railway car manufacturers to turn out all the cars that the railways urgently need.

The pertinent question now is whether it is wise to undertake so vast a program of industrial expansion at a time when inflationary pressures are strong. Success in carrying out the defense program, and indeed all progress in maintaining and raising living standards, depend in the end upon investment in plant and machinery. Nevertheless, it is impossible to do everything at once. Expenditures on plant are as inflationary as armament expenditures while they are under way, because the product does not immediately return to the market in the form of consumers' goods to supply the purchasing power created. Thus it is essential to ask of each of these projects, as of every other expenditure in these times, is it necessary?

The country can sustain the pressures created by high level business investment if it will do without consumer goods and services to the extent necessary until the production of the new plants comes into the markets. The problem is one of short-run congestion. The solution is to effect the necessary saving, economy, and restraint in consumption until the hump is sur-

mounted. But the difficulties in the way of this solution appear in each day's news. Each politically powerful group seeks to maintain its own buying power. Proposals to tax spending and consumption make little headway. As a practical matter it can hardly be doubted that any successful anti-inflationary policy must include restraint in capital investment programs as well as in consumer spending. The principal test should be whether the investment is for defense or for the support of defense, and the responsibility for applying this test belongs alike to business management, to lenders, and to the government agencies which control the allocation of materials.

Bond Pegs Dropped

March was a month of epic developments in the bond market. After weeks of argument, mounting public discussion and criticism, the Federal Reserve and the Treasury announced a settlement of their controversy over price pegs for government bonds. The settlement involved the issuance of a new type of Treasury bond paying a higher rate, and the adoption of a new open market policy under which fixed price supports were withdrawn in the government security market and supply and demand allowed to express themselves on price quotations.

The controversy thus adjusted, Thomas B. McCabe, Chairman of the Federal Reserve Board, resigned from office, effective March 31, to be succeeded by William McChesney Martin, Jr., Assistant Secretary of the Treasury. Mr. Martin, under Secretary Snyder's direction, had worked with Chairman McCabe in reaching the agreement.

Treasury-Federal Reserve "Accord"

The latest series of developments began on March 3, just five days after the President had assigned to the Secretary of the Treasury, the Chairman of the Federal Reserve Board, the Director of Defense Mobilization, and the Chairman of the Council of Economic Advisers, the task of studying ways and means of limiting private lending while still maintaining "stability in the government security market and full confidence in the credit of the United States." On March 3 Secretary Snyder and Chairman McCabe issued the following cryptic announcement:

The Treasury and the Federal Reserve System have reached full accord with respect to debt-management and monetary policies to be pursued in furthering their common purpose to assure the successful financing of the Government's requirements and, at the same time, to minimize monetization of the public debt.

The Treasury simultaneously revealed that a new issue of "investment series" bonds, bearing 2½ per cent interest, was to be offered in exchange for the two longest-term issues of 2½ per cent "restricted" bonds now outstanding: the Victory Loan due December 15, 1972 and the Seventh War Loan due June 15, 1972.

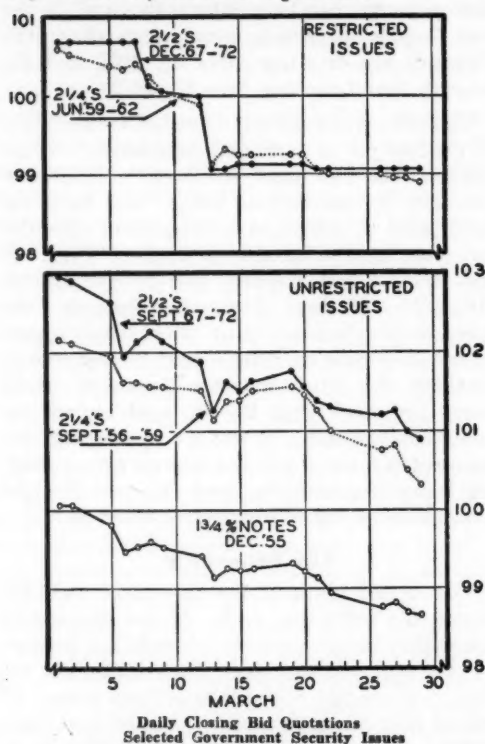
This offer was evidently intended to take some of the weight of potential liquidation off the market. The two issues involved, ineligible for purchase by commercial banks, had been the focal point of official price-supporting activities and were most vulnerable to decline. The Federal Reserve and Treasury had bought around \$1½ billion of them, September through February, to peg their prices at 100 11/16 or better. At the same time the offer served the purpose of breaking the fetish that the Treasury should never pay more than 2½ per cent current interest on its bonds. It was an appropriate adjustment to a rising scale of interest rates reflecting heavy demands for funds to meet the defense drive on top of very active business.

The Unpegging

The second phase of the agreement unfolded during the following week. At the opening of the market Monday morning, March 5, it became quickly apparent that, with the exception of the Victory Loan and Seventh War Loan issues, all official bids for government securities had been withdrawn and prices were being allowed to find their own levels. The authorities continued to pay 100 11/16 for the two issues for three days, buying heavily to hold the peg, but on Thursday, March 8, the authorities let these go too. Demand for them came into the market around par, and some potential sellers withdrew their offerings when they discovered that premium bids were no longer available. Par thus became a resistance point on the decline and official buying encouraged rallying tendencies. However, offerings increased on Monday, March 12, and the authorities pulled out of the market, permitting declines to as low as 99. At this level offerings tended to dry up and bids came into the market from buyers attracted by the availability of government obligations at a discount. With intermittent official buying, the Victory Loans, and other restricted issues as well, were stabilized around this level.

The following chart, showing the daily price movements for six strategic issues, gives a picture of what happened in various areas of the market as the price floors were taken away. On March 30 the Victory Loan 2½s were quoted at 99 1/16 bid, 99 3/16 asked, offering a yield to the

buyer of 2.55 per cent to maturity. Bought at this discount and exchanged for the new 2½s, they offered a yield of 2.79 per cent.



The price declines for the month ranged from 1½ to 2¼ points on long-term 2½ and 2½ per cent bonds restricted as to commercial bank purchase. Unrestricted bonds, which command higher prices than restricted issues because of their wider distribution and marketability, continued to slide off after the restricted list had been stabilized. Declines for the month amounted to about ½ point on issues first callable in 1952, 1¼ points on issues first callable in 1956, and 2 points for the longest-term issue in this class, the 2½s of September 1967-72. Most of the unrestricted bonds stayed above par but the five-year 1¾ per cent Treasury notes sold last December, which had been supported at 100 1/16, traded as low as 98¾. Other notes, already below par, eased off by lesser amounts.

A Skillful Operation

The authorities handled the withdrawal of the pegs with courage and skill. Uncertainty is a hall-mark of a free market and no one could have said surely what might happen when the guaranteed minimum prices were taken away. The burden placed upon government security dealers was sudden and heavy. They had to

assume larger risks and relearn the art of making a genuine two-way market without reliance on the Federal Reserve to absorb securities in supply or to supply securities in demand.

While uncertainties were great, there was never any serious risk that government securities would have a wide-open break. For one thing, investment institutions which are the largest holders of the long-term government bonds were not under pressure to sell at any price, and they have in any case an aversion to unnecessary loss-taking. Secondly, at the same time that it became less attractive for existing holders to sell government bonds, it became more attractive for anyone with new investment funds to buy them. The authorities could rely on these circumstances to provide a natural cushion under the market.

The Federal Reserve took specific precautions to avoid applying pressure on bank reserves in the transition period. The Reserve Banks, while purchasing substantial amounts of long-term securities in the first few days of the operation, refrained from selling short-term to any significant extent and allowed excess funds to accumulate in the money market. In consequence, some of the shortest-term government securities were advancing in price at the very time that long-term restricted bonds were slipping under par. In the third week of the month, the Federal Reserve sold \$100 million of Treasury notes. With Treasury tax collections this brought pressure on the money market and led to a rise in yields on Treasury bills from the former protected rate of 1½ per cent to 1¾ per cent. In the fourth week the Federal Reserve entered the short-term market as a buyer, easing the pressure that had developed on bank reserves and preventing a further rise in bill yields.

The following table summarizes the open market transactions carried out by the Federal Reserve Banks in the four weeks of March:

Federal Reserve Open Market Operations
(In Millions of Dollars)

	Holdings		Weekly Changes			
	Feb. 28 1951	Mar. 28 1951	Mar. 7 1951	Mar. 14 1951	Mar. 21 1951	Mar. 28 1951
Bills	1,527	1,599	- 4	- 13	- 10	+ 99
Notes	14,961	14,975	+103	- 7	-100	+ 18
Bonds*						
0-5 yrs.	1,578	1,602	+ 13	- 1	+ 9	+ 3
5-10 yrs.	987	1,029	+ 37	+ 37	+ 9	+ 14
Over 10 yrs.	2,828	3,401	+136	+231	+ 32	+124
Total	21,881	22,603	+298	+247	- 78	+258

* Classification based on maturity or first optional call date.

Aside from the Federal Reserve Banks' activities, the Treasury bought long-term governments in large volume, at first to help hold pegs and later to help the market achieve a restabili-

zation. The Treasury's main purchases were for the account of the Postal Savings System. The exact amount is not known but the Treasury Daily Statements show that from March 1 to 14 the Treasury redeemed \$500 million 2 per cent Treasury notes held by Postal Savings, undoubtedly for the purpose of putting the account in funds for open market purchases in corresponding amounts. Basically, it was surplus tax revenues that made the heavy purchases by the Treasury possible. March was the biggest tax collection month in the nation's history, and despite the retirement of the notes held by Postal Savings, and retirement also of Savings notes and bonds held by the general public, Treasury cash balances rose \$2½ billion to \$8 billion in the first twenty-six days of the month.

Interest Rate Changes

The decline in prices of government securities made them more attractive to investors with free investment funds. The increase in yield ranged between ½ and ¾ per cent on most issues. More or less corresponding changes occurred in prices and yields on high-grade corporate, state and municipal bonds. On short-term open market paper — Treasury bills, bankers' acceptances, and commercial paper — rates increased ½ per cent or thereabouts:

	Mar. 2, 1951	Mar. 30, 1951
Short-Term Money Rates		
91-day Treasury bills	1.89%	1.51%
90-day prime bankers' acceptances	1½	1½
4-6 months prime commercial paper	1½	2
Call loan rate	2	2
Prime commercial loan rate	2½	2½
Discount rate, Federal Reserve Bank of N. Y.	1½	1½
Bond Yields		
Restricted U. S. Governments		
2½s, June 1959-62	2.17	2.86
2½s, Dec. 1967-72	2.44	2.55
Unrestricted U. S. Governments		
2½s, Sept. 1956-59	1.83	2.14
2½s, Sept. 1967-72	2.28	2.43
Corporate and Municipal		
AAA corporate bonds*	2.69	2.85
Baa corporate bonds*	3.18	3.28
High grade municipal bonds†	1.65	1.94

* Moody's Investors Service. † Standard & Poor's Corporation.

Effects

The unpegging represents perhaps the most effective measure of credit restraint applied in the postwar period. This is so because the Federal Reserve, by limiting their purchases of government securities, cut down on the basic supply of credit. Further additions to the money supply now are obtained by most lenders only by selling government securities at a loss.

What has puzzled many people attempting to appraise the effectiveness of the unpegging is that, while they can see government bond prices decline, they cannot so easily identify the potential seller who has been dissuaded from

selling by the decline and the marginal buyer who has been attracted into the market by the lower price. They can see increases in interest rate as reported in the press without being aware of the difference this makes in the calculations and decisions of countless borrowers, lenders, and investors all over the country. These effects are vigorous and pervasive.

One of the most important effects of the unpegging will be on the cost and availability of mortgage money. This may take some time to show itself in the statistics since lenders have made forward commitments running many months ahead. Heretofore, the authorities have attempted to cut down building by direct controls over the terms of mortgage lending (the Federal Reserve's "Regulation X") and over the availability of materials. But at the same time they have been pushing the building boom full tilt by paying premium prices for long-term government bonds. Billions of dollars of mortgage loans have been granted since the war out of the proceeds of sale of long-term government bonds. The premium pegs have invited holders to do so and to take a profit on the governments in the course of the transaction. This inflation chain has had a vital link taken out — the assurance of a ready buyer of governments at a high price.

During March a number of major insurance companies made emergency cuts in their mortgage buying programs of as much as 50 per cent. Savings institutions generally adjusted their programs to the changed circumstances. Private pension funds, growing in number and resources, determined to invest in U. S. government obligations money that required a better return than the 2½ per cent maximum previously available on governments.

Banks, which generally have concentrated their government security holdings on issues maturing within five or ten years, found that the price declines put their government portfolios in red ink — below book value. Thus they were placed in a position where, to increase loans, they had either to cut down cash assets, and thus sacrifice liquidity, or to take losses on the sale of government securities.

The Exchange Offer

The two issues involved in the exchange offer announced March 3, the 2½s of June 1967-72 and the 2½s of December 1967-72, are outstanding in the aggregate amount of \$19.7 billion. Of these, approximately one-fourth are held by the Federal Reserve Banks and Treasury investment accounts, the greater part acquired in price

support operations since the war. A balance of between \$14 billion to \$15 billion is estimated to be held by investment institutions and the public at large. By the terms of the Treasury's offer the holder is given the option, for a limited time, to make an exchange for a new issue of 2½ per cent bonds first callable April 1, 1975 and maturing April 1, 1980. Subscription books for the exchange were opened March 26 for a period of approximately two weeks.

The new 2½ per cent bonds are unique in a number of respects, quite apart from the fact that the rate offered breaks the old 2½ per cent rate pattern. The new bonds, denominated "investment series" Treasury bonds, are registered in the name of the holder and, although they may be pledged as collateral security, they are not saleable in the open market and they carry no direct cash redemption privilege. However, the holder who unexpectedly needs to cash in prior to maturity is given an "out" in the shape of a privilege to convert at any time into an equivalent amount of five-year 1½ per cent Treasury notes of the regular marketable type. Thus, if need arises, he can realize cash by converting his bonds into notes and selling the latter in the open market. In times when, as at present, 1½ per cent notes are trading in the market at a discount below par, some penalty would be involved in this procedure. Such a penalty is analogous to the loss of interest the holder of a Savings bond experiences when he turns it in for redemption prior to maturity.

Once these rather complicated terms and conditions had been evaluated, many holders decided to make the exchange. The Metropolitan Life Insurance Company, for example, determined to exchange all its \$565 million holdings, the largest single block of securities eligible for the exchange outside the official accounts. Other major insurance companies are following suit. Holders anticipating early needs for cash generally sold out and found a demand from investors attracted by the availability, at a discount, of government securities exchangeable for 2½ per cent bonds. A substantial exchange is assured.

Conclusions

It is disturbing, in a time of national emergency, to have two agencies of government in sharp disagreement on essential policy. The elimination of the bond price pegs as an object of controversy, and the appointment of Mr. Martin as Chairman of the Federal Reserve Board, should usher in a new era of better feeling between the Federal Reserve and the Treas-

ury. While it is still to be demonstrated that rigid pegs on the bond market have been wholly abandoned as a matter of policy, no one should have any relish for reawakening the conflicts, fears and frustrations that went with the pegs.

During the course of the controversy varying opinions were expressed as to which agency might win. But the real contest was not between agencies of government, nor between personalities, but between sound and unsound practices of public finance. The most genuine victor is the average citizen who had been concerned about the declining purchasing power of the dollar and the wasting value of his savings. He can rest assured that, by the "Accord", the two agencies have joined in an effective action to curb inflation.

Voluntary Credit Restraint Program

The unpegging of the bond market gave practical support to the "Program for Voluntary Credit Restraint", which has been set up under the authority of Section 708 of the Defense Production Act of 1950. The program, the result of a series of conferences held by representatives of the American Bankers Association, the Life Insurance Association, the Investment Bankers Association, and the Federal Reserve Board, was cleared with the Attorney General early in March and a request for cooperation in the program went forward to financing institutions throughout the country under date of March 9. The plan operates through a "Voluntary Credit Restraint Committee" appointed by the Federal Reserve Board, and through regional subcommittees which will be available for consultation by institutions participating in the program.

The program goes further than the similar one carried on by the American Bankers Association in 1948. It is applicable to all financing institutions whether they fall under the heading of "banks" or not. It has a word of blessing in law as well as the endorsement of the President. It has the decline in the bond market to back it up, plus the fact that many banks are already well loaned up, and the recognized increase in credit risk that goes with inflated prices and enlarged inventories.

Financing institutions are being informed concerning the program by the circulation of a "Statement of Principles" by the Federal Reserve Board, by communications from their respective associations, and by bulletins issued by the central committee. The purpose is to secure voluntary action by banks, insurance companies, investment bankers, and other lenders to refrain

from making loans for non-productive purposes, thus helping to control existing inflationary pressures. At the same time, it is recognized that adequate credit for the defense program and for the normal and essential needs of agriculture, industry, and commerce is vitally necessary. The "Statement of Principles" is intended to be a measuring stick for lenders to use in the extension of credit. The first bulletin issued by the committee, March 19, struck at credits to carry inventories beyond reasonable requirements.

Mr. James E. Shelton, President of the American Bankers Association, under the date of March 21 sent his members a circular letter in support of the program. His two concluding paragraphs are quoted below:

I am confident that effective cooperation by banks and other lenders in this voluntary program will demonstrate the undesirability of the imposition by the government of rigid credit controls. Such controls would only hamper the efforts of business, industry, agriculture, and commerce to produce the amounts of goods and services necessary to the defense program and to the maintenance of a sound domestic economy.

I earnestly urge all banks and bankers, in extending credit, to comply with both the letter and the spirit of the Statement of Principles which are the heart of this program. By so doing, we shall be voluntarily making our contribution as bankers to the effort to lessen inflationary pressures and thereby help to preserve the purchasing power and the integrity of the American dollar.

For banks in major cities the local clearing houses provide a natural meeting ground for enlisting cooperation in the program. On March 22 the members of the New York Clearing House Association unanimously declared "their intention to participate to the fullest extent in the Program" and promised "their complete cooperation to comply with its provisions in order that the basic purposes and policies to combat inflation and to strengthen the domestic economy may be fulfilled."

For fullest success the program will require restraint not only on the part of lenders but also on the part of borrowers. They are in the best position to gauge how and where their credit demands can be reduced. Further, cooperation will be needed with agencies allocating scarce materials which have legal powers of restraint by this means.

1950 Corporate Earnings

Additional reports for 1950 issued during March by more than 1,000 corporations bear out the preliminary summary of earnings given here a month ago in reflecting the peak levels of activity reached during the year by most of the major lines of business. The rise in net income

of leading corporations was accompanied by similar increases to record levels in other major operating items, including revenues from sales and other sources, and payments for wages and salaries, goods and services purchased, federal and other taxes, and dividends to shareholders, as well as investment of funds for improving plant and equipment and for building up working capital.

The expansion in dollar figures represents in part merely the rise of commodity prices and the corresponding fall in purchasing power of the dollar. This condition of inflation has the effect of swelling reported earnings in two principal ways—despite accounting methods designed to minimize it.

One way is the inclusion of nonrecurring profits resulting from the selling out of merchandise bought at lower prices. Since the receipts were immediately reinvested in new inventory at the higher current prices, such profits were not available for distribution as dividends or for other purposes. According to the January report of the President's Council of Economic Advisers, the net availability of funds from the profits after taxes of all U. S. corporations in 1950, after allowing for the change in costs of replacing inventories, was about 10 per cent below 1949, the previous peak.

The other way is the understatement of operating expenses by charging the depreciation against plant and equipment on the basis of original costs, which are far below replacement costs. Both of these factors tend to cause an overstatement of reported earnings, expressed either in dollars or as a percentage profit margin on sales.

When earnings are expressed as a percentage return on net assets, there is a third element of overstatement—the fact that such assets are based upon balance sheet valuations far below current values.

Earnings by Major Groups

Our tabulation of the annual reports now issued by 3,304 corporations in all major lines of business shows a combined net income in 1950 of approximately \$13.6 billion after taxes, compared with \$10.5 billion in 1949, an increase of 30 per cent. This is only two percentage points less than the increase shown by our preliminary summary. A detailed table by 70 major industrial groups appears on the next page, while a condensed summary follows.

The average profit margin in 1950, based on the figures of sales or operating revenues published by about nine-tenths of all reporting non-

NET INCOME OF LEADING CORPORATIONS FOR THE YEARS 1949 AND 1950

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net In- come After Taxes		Per Cent Change ^a	Book Net Assets Jan. 1 - a		% Return on Net Assets - b		% Margin on Sales - b	
		1949	1950		1949	1950	1949	1950	1949	1950
22	Baking	\$ 63,629	\$ 63,615	—	\$ 857,759	\$ 895,678	17.8	16.1	5.2	5.0
16	Dairy products	81,064	79,345	— 2	524,552	569,378	15.5	13.9	3.2	3.0
19	Meat packing	32,419	52,646	+62	819,228	824,482	4.0	6.4	0.5	0.8
20	Sugar	39,067	51,502	+32	465,079	478,781	8.4	10.8	4.4	5.5
78	Other food products	228,198	267,403	+17	1,628,949	1,727,148	14.0	15.5	4.8	5.1
15	Soft drinks	43,404	41,535	— 4	263,325	268,564	16.5	15.5	10.4	11.2
27	Brewing	55,614	41,202	— 26	251,183	280,917	22.1	14.7	8.2	6.6
13	Distilling	114,907	148,770	+29	756,684	829,814	15.2	17.9	5.5	6.6
23	Tobacco products	152,508	148,231	— 3	1,076,470	1,177,303	14.2	12.6	5.5	5.2
38	Cotton goods	67,574	89,524	+32	680,321	703,543	9.9	12.7	5.8	6.2
17	Silk and rayon	67,932	108,781	+60	517,541	553,063	13.1	19.7	9.1	12.8
9	Woolen goods	10,763	16,284	+51	198,270	199,877	5.4	8.1	2.6	3.9
18	Hosiery, knitted goods	14,595	23,928	+64	119,248	132,534	12.2	18.1	5.1	8.2
47	Other textile products	96,399	142,462	+48	877,689	921,827	11.0	15.5	5.3	6.7
33	Clothing and apparel	20,174	27,053	+34	248,589	252,370	8.1	10.7	3.1	4.2
10	Leather tanning	2,081	4,067	+95	68,970	66,539	3.0	6.1	1.0	2.0
22	Shoes, leather products	27,542	35,008	+27	260,437	267,705	10.6	13.1	3.4	4.3
26	Tires, rubber products	85,967	160,070	+86	988,056	1,019,370	8.7	15.7	3.6	4.9
28	Lumber	56,411	91,178	+62	527,441	562,626	10.7	16.2	8.3	9.9
14	Furniture, wood products	16,464	24,631	+50	151,519	159,935	10.9	15.4	5.5	6.8
76	Pulp and paper products	217,007	307,576	+42	1,691,225	1,822,346	12.8	16.9	8.1	10.2
26	Printing and publishing	37,735	40,207	+ 7	257,257	266,351	14.7	15.1	5.5	5.7
65	Chemical products	543,411	742,513	+37	3,178,535	3,484,916	17.1	21.3	10.3	11.7
34	Drugs, soap, cosmetics	134,375	180,541	+42	531,853	586,339	16.2	21.5	7.1	9.9
23	Paint and varnish	40,204	67,776	+69	891,148	898,552	10.3	17.0	4.5	6.4
45	Petroleum products	1,412,866	1,730,484	+22	10,730,453	11,618,635	13.2	14.9	9.9	10.8
30	Cement	57,254	60,738	+ 6	304,379	333,285	18.8	18.2	15.8	15.4
10	Glass products	98,419	121,014	+30	470,746	512,532	19.3	23.6	9.9	10.9
46	Other stone, clay products	101,225	146,293	+45	741,373	791,436	13.7	18.5	9.5	10.8
55	Iron and steel	555,423	785,793	+41	4,794,447	5,128,129	11.6	15.3	7.2	8.1
11	Agricultural implements	174,046	193,259	+11	1,100,940	1,236,577	15.8	15.6	7.6	8.3
72	Building, heat, plumb. equip. ..	101,557	152,808	+50	807,759	862,691	12.6	17.7	6.3	7.8
83	Electrical equip., radio & tv. ..	540,931	807,156	+49	1,968,121	2,209,711	17.3	23.0	6.1	7.3
49	Hardware and tools	34,414	56,659	+65	368,660	385,717	9.3	14.7	5.8	8.2
44	Household appliances	61,697	95,773	+55	399,714	429,520	15.4	22.3	5.3	7.7
154	Machinery	181,795	218,140	+20	1,462,439	1,547,623	12.4	14.1	7.0	7.6
30	Office equipment	95,862	109,169	+14	522,125	573,667	18.4	19.0	9.6	9.8
38	Nonferrous metals	198,658	359,631	+81	2,472,117	2,528,795	8.0	14.2	8.2	9.8
101	Other metal products	142,567	213,388	+50	1,278,798	1,318,991	11.1	16.2	5.0	6.3
26	Autos and trucks	856,922	1,053,719	+23	2,887,957	3,257,326	30.2	32.3	8.9	8.9
64	Automobile parts	175,761	234,565	+33	928,233	1,033,072	18.9	22.7	6.3	7.4
25	Railway equipment	58,135	58,073	—	804,394	792,530	7.2	7.3	4.4	5.5
27	Aircraft and parts	47,370	82,941	+75	580,594	586,257	8.2	14.1	3.3	4.5
5	Shipbuilding	6,792	D-1,512	—	79,143	83,241	8.6	—	5.0	—
60	Misc. manufacturing	100,373	144,272	+44	878,253	923,376	11.4	15.6	7.6	9.0
1,693	Total manufacturing	7,046,221	9,288,170	+32	50,662,062	54,403,419	13.9	17.1	6.8	7.7
27	Coal mining - c	49,002	60,852	+24	676,176	692,809	7.2	8.8	5.2	5.9
24	Metal mining - c	34,425	69,998	+100	479,643	447,488	7.2	15.6	9.2	12.2
36	Oil and gas - c	99,625	110,004	+10	543,543	600,527	18.3	18.3	26.9	21.9
11	Other mining, quarrying - c ..	36,060	40,865	+13	122,705	135,787	29.4	30.1	26.9	26.6
98	Total mining, quarrying	219,112	281,719	+29	1,822,067	1,876,561	12.0	15.0	12.3	12.6
17	Chain stores - food	57,824	63,108	+ 9	317,457	352,242	18.2	17.9	1.6	1.7
57	Chain stores - variety, etc. ..	135,584	152,635	+13	1,103,994	1,152,818	12.3	13.2	4.3	4.8
45	Department & specialty	158,891	170,678	+ 7	1,198,321	1,269,129	13.3	13.4	3.5	3.6
6	Mail order	189,754	211,454	+12	1,072,397	1,155,963	14.9	18.3	4.6	5.7
53	Wholesale & miscellaneous	64,481	81,048	+26	607,038	646,808	10.6	12.5	2.5	2.9
178	Total trade	576,534	678,923	+18	4,299,197	4,576,960	13.4	14.8	3.3	3.8
132	Class 1 railroads - d	438,035	783,377	+79	13,725,192	13,923,456	3.2	5.6	5.1	8.3
37	Traction and bus	10,536	8,155	-23	439,145	440,008	2.4	1.9	1.2	1.5
13	Shipping	15,723	21,888	+39	290,416	294,107	5.4	7.4	3.3	6.9
16	Air transport	19,006	34,476	+81	256,690	284,450	7.4	12.1	3.3	4.9
50	Misc. transportation	20,138	24,813	+23	240,742	250,840	8.4	9.9	6.6	7.7
243	Total transportation	503,488	872,709	+73	14,952,135	15,192,361	3.4	5.7	4.8	7.7
230	Electric power, gas, etc. - d ..	809,927	908,709	+12	8,318,776	9,133,132	9.7	9.9	14.4	14.6
63	Telephone & telegraph - d ..	256,079	391,009	+53	3,730,331	4,105,356	6.9	9.5	7.8	10.7
293	Total public utilities	1,066,006	1,299,718	+22	12,049,107	13,238,488	8.8	9.8	11.9	13.1
15	Amusements	30,248	33,410	+10	477,280	483,132	6.3	6.9	4.4	4.9
40	Restaurant and hotel	10,751	10,674	- 1	120,233	126,187	8.9	8.5	3.9	4.4
27	Other business services	34,932	39,363	+13	220,915	236,804	15.8	16.6	7.1	8.5
17	Construction	16,908	18,796	+11	116,408	125,532	14.5	15.0	3.7	4.1
99	Total amusements, services, etc. ..	92,839	102,243	+10	934,886	971,655	9.9	10.5	4.8	5.7
298	Commercial banks - e	463,683	498,818	+ 8	5,759,415	5,968,590	8.1	8.4	...	...
66	Fire & casualty insurance - e ..	196,068	140,508	-28	1,434,602	1,754,757	13.7	8.0	...	...
158	Investment companies - e	184,416	242,715	+32	2,617,630	2,954,856	7.0	8.2	...	...
63	Sales finance companies	104,354	137,539	+32	662,306	747,696	15.8	18.4	...	...
110	Real estate companies	15,778	20,217	+28	162,024	173,004	9.7	11.7	...	...
695	Total finance	964,299	1,039,797	+ 8	10,635,977	11,593,903	9.1	9.0	...	...
3,304	Grand total	\$10,468,449	\$13,563,279	+30	\$95,355,481	\$101,908,347	11.0	13.3	6.6	7.7

a—Net assets at the beginning of each year are based upon the excess of total balance sheet assets over liabilities; the amounts at which assets are carried on the books are far below present-day values. b—Profit margins computed for all companies publishing sales or gross income figures, which represent about nine-tenths of total number of reporting companies, excluding the finance groups; includes income from investments and other sources as well as from sales. c—Net income is reported before depletion charges in some cases. d—Due to the large proportion of capital investment in the form of funded debt, rate of return on total property investment would be lower than that shown on net assets only. e—Figures represent in most cases operating earnings only, excluding gains or losses on investments. †Increases or decreases of over 100% not computed. —Deficit.

Net Income of Leading Corporations for the Years 1949 and 1950

(In Millions of Dollars)

No. of Cos.		Net Income After Taxes		Per Cent Change	% Margin on Sales	
		1949	1950		1949	1950
1,693	Manufacturing	\$7,046	\$9,288	+32	6.8	7.7
93	Mining, quarrying	219	282	+29	12.3	12.6
178	Trade	577	679	+18	8.3	8.8
248	Transportation	503	873	+73	4.8	7.7
293	Public utilities	1,056	1,300	+22	11.9	13.1
99	Amusements, services	98	102	+10	4.8	5.7
695	Finance	964	1,040	+8	—	—
3,304	Total	\$10,468	\$13,563	+30	6.6	7.7

financial companies, was 7.7 cents per dollar. This compares with the average of 6.6 cents in 1949, and is slightly above the 7.3 cents in 1948.

Net assets of the 3,304 companies at the beginning of 1950 aggregated approximately \$101.9 billion, upon which the year's net income represented an average return of 13.3 per cent. This compares with net assets in 1949 of \$95.4 billion and a return of 11.0 per cent. The 1950 rate was slightly below the 13.6 per cent in 1948, although the dollar totals of both earnings and assets increased by over one-sixth during that two-year period.

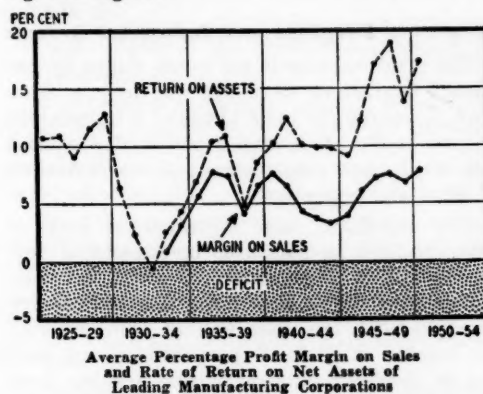
The profit figures for 1950 represent of course, water over the dam. The extensive programs now going into effect for expanding the production of military and other supplies for the armed services, and for curtailing civilian goods production in order to conserve manpower and critical materials, are bringing about sweeping changes in the position of leading industrial companies. Although civilian goods output continued generally high during the first quarter of this year, the program contemplates that the swing over to military orders will proceed at an accelerating rate.

Among the problems facing these companies are the loss of regular customers, the costly tooling up for quantity production of military items, the likelihood—as in World War II—of narrower profit margins on government contracts than on ordinary peacetime goods, the continued upward trend of costs, and the effect of price ceilings in squeezing profit margins on civilian goods. Moreover, business will feel this year the full impact of the higher federal income tax rates, and faces the possibility of still further increases under proposals now pending.

Trends in Manufacturing

In the various manufacturing industries, which in numbers and in net assets comprise more than one-half of the grand total for all reporting companies, the trends in average profit margin and return on net assets are shown in the accompanying chart based upon our annual tabulations.

The number of published reports available since 1925 has varied from a low of 1,138 in 1934 to a high of 1,710 in 1949. Profit margins were not computed in our tabulations prior to 1933 because of the limited number of companies issuing sales figures.



It will be seen that the average profit margin of 7.7 per cent in 1950 was not appreciably wider than in other years of active business. The large increase in total earnings since 1945 has not come primarily from a widening of profit margins, but from the tremendous expansion that occurred in the dollar volume of sales—resulting in part from the inflation of prices.

The 17.1 per cent return on net assets in 1950 was below that of 1948, although above the rates in most other years. Part of the rise in rate of return during recent years is due, as already explained, to the fact that net assets are carried at book values far below present-day replacement costs.

Despite the increase of 18 per cent last year in the combined total of dollar sales, and of 32 per cent in net income of the manufacturing industries, about 22 per cent of the reporting companies had a falling off in sales, while 23 per cent had a decline in net income.

1,017, or 69 per cent of the total number of companies had increases in both sales and net income.

137, or 9 per cent, had increases in sales, but decreases in net income. In these cases, costs and taxes rose more than sales.

202, or 14 per cent, had decreases in sales, accompanied by decreases in net income.

Finally, 121, or 8 per cent, had decreases in sales, but nevertheless were able to make increases in net income.

The widely varying experience of individual companies, even in a period of strong general trends, illustrates the need of using composite

figures of earnings with caution. Aside from revealing the past rather than the present, and of concealing the infinite differences among individual companies, such composites sometimes suggest a pooling of fortunes by companies which are actually in competition with one another.

Corporate Earnings and Industrial Growth

The great increase in net assets shown by our annual tabulations since the war reflects, even after allowance for price changes, a tremendous growth in the productive capacity of American business by new construction and modernization of plant and equipment.

This rebuilding and expansion of facilities have required an enormous investment of new capital, the principal source of which has been the earnings of business itself. During the five years 1946-50, less than half of the estimated net income of all U. S. corporations was paid out in dividends, the proportion ranging from a low of 36 per cent to a high of 46, and amounting to 41 per cent last year. Undistributed income aggregating over \$55 billion for the five years was retained for building up property account and working capital. By obtaining most of its new funds in this way, business avoided the increase in indebtedness that would have been involved in borrowing.

This application of income recalls the criticism often heard since the war that business was making too much money and paying out too little. Such criticism came both from labor leaders, who urged that more money should be paid out in wages, and from investors, who felt that a larger portion of net income should be distributed in dividends. In fact it has been largely due to those high earnings and to their being plowed back into financing growth and improvement that industry today is in such strong condition — physically and financially — to meet the requirements of the national defense program and at the same time maintain a high output of civilian goods.

Can Federal Expenditures Be Cut?

Individuals and business concerns who have just made their payments of the first quarterly instalment of federal income taxes will be in a mood to appreciate a report on the question in the above caption by the Committee on Federal Tax Policy, made public last month. In this report, entitled "Financing Defense: Can Expenditures Be Reduced?,"* the committee, consisting of leading fiscal authorities under the chairmanship of Roswell Magill, former Undersecretary of the Treasury, adds its testimony to other

studies showing that government expenditures can and should be cut. It recommends a reduction of at least \$10 billion from the annual rate of spending represented by the \$71.6 billion budget for the fiscal year 1952, and indicates the general areas in which savings might be looked for, as well as a budgetary procedure for making them effective.

In its approach to the problem of budget cutting, the committee adopts, instead of the customary functional breakdown of expenditures, a new classification of budget items, with the view of "focusing attention upon the character of these operations in a way that promotes a better judgment as to the wisdom and propriety of government participation in the lines of activity described."

The following table from the report gives this reclassification of the budget for the fiscal years 1949-1952:

Federal Budget Expenditures Showing Areas of Reducible Government Spending for 1952				
Fiscal Years 1949-1952				
(In Millions of Dollars)				
	1949 Actual	1950 Actual	1951 Estimate	1952 Estimate
Total	\$40,057	\$40,156	\$47,210	\$71,594
Reducible Areas:				
Gross disbursements for Loans	2,065	2,071	2,577	2,077
Expenditures for Civil Public Works, Commodity Inventories, and Equipment	2,994	2,016	1,744	2,751
Expenditures for Aids and Special Services for programs of states, local governments and others (civil) other than International	10,074	10,702	10,574	9,603
Other Current Operating Expenses	1,836	1,896	2,076	2,446
International Aid (no details in Budget)	5,554	4,392	4,218	7,008
Total Reducible Areas including International Aid	22,523	22,077	21,189	24,885
Military Services (no details in Budget)	11,014	12,308	20,994	41,421
Others Items:				
Interest payments	5,444	5,817	5,722	5,897
Noncost payments*	573	563	572	623
Receipts a/c loans	-673	-936	-1,314	-1,408
Total	5,349	5,444	4,980	5,114
Reserve for Contingencies			45	176
Adjustment to Daily Treasury Statement basis		+272	+330	

* Noncost payments are mainly for the railroad retirement trust fund, for which reimbursement through special payroll taxes is included in revenues.

The table lists, first, major budget expenditures other than military and interest. This total, which the committee designates the "reducible areas", comes to \$24.9 billion.

Military services and interest are listed separately — the former not because the committee accepted them as irreducible but because details of the military program for 1952 are not yet available for analysis.

The report notes that the "reducible area" totals have held "remarkably steady" over the

past four years except for the bulge in International Aid in 1952. "There is no reduction shown for 1952", it points out, "to help meet the great increase in military expenditures."

The committee then proceeds to review these reducible areas and to make the following recommendations:

1. A prompt withdrawal of the Federal Government from the lending field, and a limitation of its future operations to servicing and collecting outstanding loans, with an estimated saving in fiscal 1952 of \$1½ billion.

2. A deep cut in the public works program and a suspension of all projects not contributing directly to some essential defense purpose, with a resultant saving in fiscal 1952 of \$750 million.

3. Drastic curtailment of federal aid, grants, subsidy and special services programs, largely by making the States responsible for various services now supported by the Federal Government, with an estimated saving of \$3 billion in fiscal 1952.

4. Immediate application of remaining reforms outlined by the Hoover Commission and a general tightening up of federal management to eliminate waste, with a saving of \$1 billion in fiscal 1952.

Adding another \$2 billion in savings resulting from the sale of loans, mortgages, and commodities, the committee reaches a nondefense reduction goal of \$8¼ billion.

With respect to defense expenditures, the report does not attempt to analyze the \$41 billion listed in the 1952 budget for the military aid, or the \$7 billion included for international aid. But it expresses conviction that possibilities of cuts in these areas will appear, "once the Government becomes imbued with the purpose of being wisely economical." It warns against considering items as sacred and untouchable merely because of their having been given a "defense" label. "It is certain," the report declares, "that large savings could be accomplished by eliminating waste and extravagance in the military budget."

After making allowance for these and other opportunities for savings that a more exhaustive inspection of the budget might reveal, the committee arrives at its "conservative" conclusion that a reduction of "at least" \$10 billion in expenditures is possible, "while still leaving intact all the government that a free nation requires."

A "Clean-Slate" Approach

The committee rejects the expedient of a percentage-cut across the board on all nondefense items as "an unsatisfactory bludgeoning process that hurts equally the useful items with the bad ones." Such action "penalizes any executive department that has done good work in cutting waste and is operating efficiently just as severely as the inefficient and extravagant operation."

Also, as the chairman Mr. Magill pointed out in a press conference, some \$35 billion in the proposed budget comes from previous authorizations and commitments. These limit the scope for Administrative or Congressional action in cutting down spending so long as they remain on the books.

In this situation, the committee proposes a bold program:

1. That Congress start with a clean slate by suspending for three years the operation of every provision requiring expenditures or appropriations, with the exception of direct military expenditures, international aid, and interest on the debt.

2. That Congress obtain from the Budget Bureau new proposals on this clean-slate basis for a total expenditure budget of \$10 billion less than the present proposal.

3. The Congress would then proceed with the consideration of these revised proposals, with the goal of approving a final total of expenditures \$10 billion below the present budget.

4. This clean-slate policy will enable the Congress to obtain a better continuing future control over expenditures. The practice of appropriating tremendous amounts, which are carried forward to be spent in subsequent years, has weakened this control.

Drastic Measures Necessary

This is, to be sure, a drastic program. However, as the committee says, "the drastic demands of the present situation require drastic action." Whether the program is right or not in detail, there is no question as to the soundness of the main thesis — (1) that the projected rate of government spending means either inflation or crushing taxes that strike at the roots of our industrial progress, and (2) that a genuinely economy-minded Administration and Congress could save billions of dollars now being frittered away in bureaucratic inefficiencies or spent on projects neither essential to defense nor justified under present conditions, if ever.

* *Financing Defense: Can Expenditures Be Reduced?* Committee on Federal Tax Policy, 50 West 50th St., New York, 1951. Members of the committee: Chairman, Roswell Magill, Cravath, Swaine and Moore, New York, Professor of Law at Columbia University, formerly Undersecretary of the Treasury; Fred R. Fairchild, Knox Professor Emeritus of Economics at Yale University, formerly president of the National Tax Association; Rowland R. Hughes, Comptroller of the National City Bank of New York, member of Tax Committee of National Foreign Trade Council and of Controllers Institute; Walter A. Cooper, Peat, Marwick, Mitchel & Co., New York, chairman of committee on Federal Taxation of the American Institute of Accountants; Thomas N. Tarleau, Willkie, Owen, Farr, Gallagher and Walton, New York, formerly Tax Legislative Counsel to the Secretary of the Treasury. Committee Secretary, Alfred Parker.

*Patterns in
Pensions*

YOUR RETIREMENT PROGRAM

SHOULD BE GEARED TO YOUR COMPANY EARNINGS

IF your company EARNINGS ARE STEADY

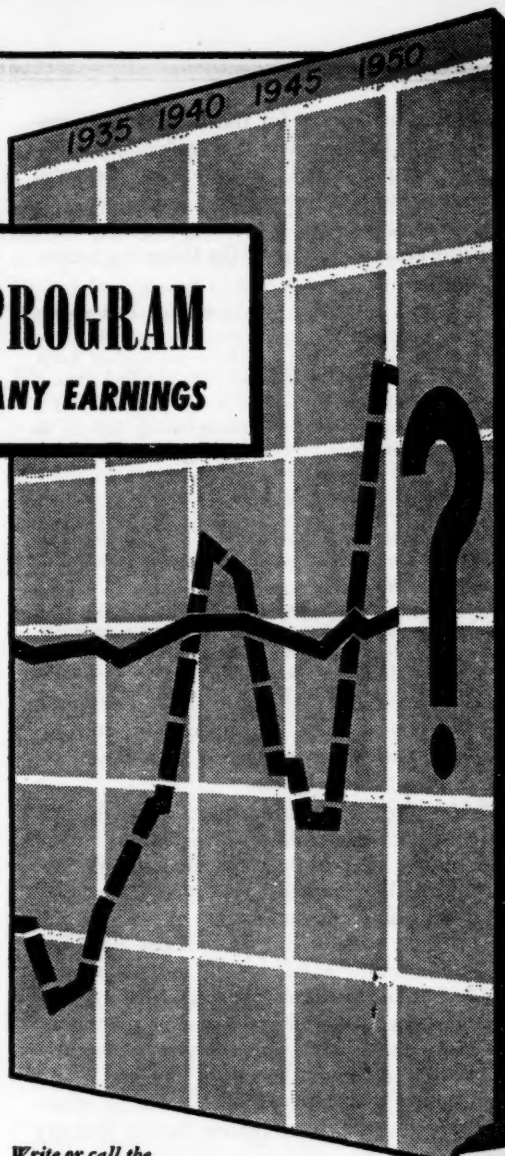
Your company probably can afford the permanent commitment of an adequate pension system:

IF your company EARNINGS ARE ERRATIC

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